

**THE COMMONWEALTH OF MASSACHUSETTS  
BEFORE THE  
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY**

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**Western Massachusetts Electric Company  
Electric Industry Restructuring Proposal**

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**D.T.E. 97-120**

**DIRECT TESTIMONY OF  
HENRY Y. YOSHIMURA**

**Regarding Retail Standard Service Transition Rates**

**On Behalf of:**

**THE COMMONWEALTH OF MASSACHUSETTS  
DIVISION OF ENERGY RESOURCES**

**October 9, 1998**

DIRECT TESTIMONY OF HENRY Y. YOSHIMURA  
REGARDING RETAIL STANDARD SERVICE TRANSITION RATES  
WESTERN MASSACHUSETTS ELECTRIC COMPANY, D.T.E. 97-120

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1 **I. WITNESS IDENTIFICATION**

2

3 **Q. Mr. Yoshimura, please identify yourself for the record.**

4 A. My name is Henry Y. Yoshimura. I am the Senior Manager of Economics and Public

5 Policy for XENERGY Consulting, Inc., 2001 West Beltline Highway, Madison,

6 Wisconsin 53713.

7 **Q. Are you the same Henry Y. Yoshimura who submitted direct testimony earlier in**  
8 **this proceeding on WMECo's proposed Standard Offer procurement procedure?**

9

10 A. Yes, I am.

11 **Q. Is the testimony you are about to give, including all supporting exhibits and/or**  
12 **schedules, prepared by you, or under your supervision and guidance?**

13

14 A. Yes.

15 **Q. Please describe the contents of this volume of direct testimony.**

16

17 A. This volume of direct testimony consists of the following sections:

18 I. Witness Identification

19 II. Purpose and Summary of the Direct Testimony

20 III. Legal and Policy Considerations with Respect to Standard Service Rate Levels

21 IV. Establishing Standard Service Rate Levels That Meet the Requirements of the Act

22 V. Proposed Standard Offer Rate Methodology and Modifications to Transition  
23 Charge Estimates

24 VI. Estimated Standard Service Prices and Transition Costs

25

26 **II. PURPOSE AND SUMMARY OF THE DIRECT TESTIMONY**

27 **Q. What is the purpose of the testimony you are now about to give?**

28

29 A. The Massachusetts Division of Energy Resources ("DOER") asked me to review the

30 method by which Western Massachusetts Electric Company ("WMECo" or "Company")

1 proposes to establish its Standard Service Transition Rate. Specifically, the DOER asked  
2 me to evaluate the Company's proposal for consistency with the objectives of the  
3 Massachusetts Electric Industry Restructuring Act, Chapter 164 of the Acts of 1997  
4 ("Act"),<sup>1</sup> and to propose an alternative methodology to the extent WMECo's proposal is  
5 inconsistent with the objectives of the Act.

6 **Q. Please summarize your evaluation of WMECo's Standard Service Transition Rate**  
7 **methodology.**

8  
9 A. The Company proposed a schedule of Standard Service Transition Rates (also known as  
10 "Standard Service" or "Standard Offer") to be charged to retail customers that is similar  
11 but not identical to those filed by other Massachusetts electric companies in the  
12 Commonwealth such as Massachusetts Electric Company, Boston Edison Company, and  
13 Eastern Edison Company. According to the Act, all distribution companies are required  
14 to provide a Standard Service Transition Rate to those customers who were located  
15 within their service territory and who chose not to purchase electricity from a non-  
16 affiliated generation service provider as of March 1, 1998. St. 1997, c. 164, § 193 (G.L.  
17 c. 164, § 1B(b)). The price schedule proposed by the Company is summarized below:

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<sup>1</sup> The full and official name of the Act is: "Chapter 164 of the Acts of 1997: An act relative to restructuring the electric utility industry in the Commonwealth, regulating the provision of electricity and other services, and promoting enhanced consumer protections therein."

**TABLE 1**  
**Standard Service Prices Proposed by WMECo**

<u>Transition Year</u>	<u>Price (cents per kWh)<sup>2</sup></u>
1998	2.80
1999	3.10
2000	3.40
2001	3.80
2002	4.20
2003	4.40
2004-5	4.49

It is my understanding that the Company's most recent proposal is to charge Standard Offer customers the price schedule from its December 31, 1997 filing, or a price based on the wholesale cost to supply Standard Offer generation, whichever is lower. This most recent proposal, which was revealed during the cross-examination of Mr. Richard Soderman by DOER counsel, is a significant change relative to the Standard Offer proposals advanced by other electric companies in the Commonwealth. See Tr. Vol. 3, pp. 476-480.

Before March 1, 1998, the Department reviewed and approved a number of restructuring plan settlement agreements that incorporated as one component of the package a Standard Service price schedule and methodology similar but not identical to that proposed by WMECo in this proceeding. At the time the Department approved the first few restructuring plan settlement agreements (e.g., Massachusetts Electric Company,

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<sup>2</sup> See Exhibit 13E, Schedule 2, page 2A of 14. The Company's most recent Standard Offer proposal differs significantly from that proposed in its initial restructuring plan dated December 31, 1997 (See WMECo Initial Restructuring filing, December 31, 1997, p. 27.)

1 Boston Edison Company), the impact of the Standard Service price schedule on the  
2 development of the competitive retail generation market was not known. Since the  
3 opening of the retail market on March 1, 1998, it appears that the Standard Service  
4 schedule implemented by these other Massachusetts electric companies may be inhibiting  
5 the development of a competitive retail generation market. Unfortunately, WMECo is  
6 proposing a similar Standard Service rate schedule and methodology which would only  
7 exacerbate the creation of a competitive retail generation market in Massachusetts. Since  
8 one of the primary objectives of the Act is to foster a complete and expeditious transition  
9 to a competitive retail generation market, the Standard Service price schedule and  
10 methodology advanced by WMECo in this case should be reexamined in light of what  
11 we know today.

12  
13 Accordingly, I was asked by the DOER to develop an alternative Standard Service  
14 pricing methodology that would be more consistent with the portion of the Act that  
15 requires the complete and expeditious transition to a competitive retail generation market  
16 during the period over which electric companies are required to provide Standard Service  
17 ("Transition Period"). In addition to encouraging the development of a competitive  
18 market during the Transition Period, the DOER asked me to develop the proposal so that  
19 electric companies would have a reasonable opportunity to collect their reimbursable  
20 Transition Costs as defined and authorized by the Act, and to meet the 10 and 15 percent  
21 rate reduction requirement for years 1998 and 1999, respectively, as set forth by the Act.

22 **Q. Please summarize your proposed Standard Service Transition Rate methodology in**  
23 **relation to what the Company has proposed.**

1 A. One of the primary features of WMECo's Standard Service Transition Rate proposal  
2 involves the deferral and securitization of costs that are under-collected as a result of the  
3 difference between the retail Standard Offer rate schedule proposed by WMECo, and the  
4 price of the power acquired to serve Standard Offer load. As discussed in my testimony  
5 submitted in this proceeding on September 25, 1998, the Company plans to use a  
6 competitive bidding process to acquire power to serve Standard Offer load.<sup>3</sup> If this RFP  
7 were properly structured, potential suppliers of the Standard Offer load would offer  
8 generation to WMECo at competitive market prices. The Company assumes (and other  
9 evidence suggests) that market rates will substantially exceed the proposed retail  
10 Standard Offer price schedule for several years. WMECo proposes to defer, securitize,  
11 and recover from all ratepayers through Transition Charges, with interest, the under-  
12 recovered costs associated with the difference between Standard Offer revenues and  
13 supply costs.

14  
15 In contrast to the Company's proposed methodology, I recommend that the Department  
16 adopt the following policies with respect to the methodology used to determine the  
17 Standard Service Transition Rate:

- 18 1. Rather than charging Standard Offer customers a generation rate based on a  
19 schedule that has no relationship to the cost of serving Standard Offer loads, I  
20 propose that Standard Offer customers be charged a rate equal to the then current

---

<sup>3</sup> As mentioned in my earlier testimony, WMECo's proposed procedure for acquiring generation to serve Standard Offer load is replete with structural and procedural flaws that must be addressed before implementation of any solicitation process.

1 cost-of-service. In other words, customers purchasing Standard Offer service  
2 should pay a generation rate based on current payments made to the providers of  
3 Standard Offer generation.

- 4 2. Since retail Standard Offer prices will reflect what the market will bear, high  
5 Standard Service Transition Rates, together with transmission, distribution, and  
6 Transition Charges, could make the combined rate exceed the 10 and 15 percent  
7 rate decreases for years 1998 and 1999, respectively, that are required by the Act.  
8 In order to ensure that the overall rate charged to Standard Offer customers does  
9 not exceed the mandatory rate decreases, I propose that the recovery of  
10 reimbursable Transition Costs be deferred and potentially securitized to the extent  
11 Transition Charges are not sufficient to recover current Transition Costs.<sup>4</sup>  
12 Deferred Transition Costs should be recovered through Transition Charges once  
13 the rate cap<sup>5</sup> is no longer a constraint to their recovery.

14 Accordingly, the major difference between my proposed Standard Service Transition  
15 Rate methodology and that of WMECo revolves around which set of costs (i.e., Standard  
16 Offer under-collections, or reimbursable Transition Costs) ought to be deferred and  
17 potentially securitized in order to meet the mandatory rate decreases and rate cap

---

<sup>4</sup> Obviously, securitization of reimbursable Transition Costs should be used only if it is proven to be beneficial to ratepayers.

<sup>5</sup> By rate cap, I am referring to the maximum rate that Standard Offer customers could be charged in any given year. After the 10 and 15 percent rate reductions in years 1998 and 1999, respectively, rates are allowed to increase based on the rate of "... inflation from August 1997 or such other date as the Department may determine to be representative of 1997 rates for such company, which was the benchmark for the March 1, 1998, rate reduction...." St. 1997, c. 164, § 193 (G.L. c. 164, § 1B(b)).

constraints required by law. As supported by my findings below, reimbursable

Transition Costs are the costs that ought to be deferred and potentially securitized.

**Q. Please summarize the conclusions that support your proposed Standard Service Transition Rate methodology.**

A. I have reviewed the Massachusetts Electric Industry Restructuring Act and the Company's proposal, and I have conducted an analysis of my proposed Standard Service Transition Rate methodology. From these, I have drawn the following conclusions:

1. WMECo's proposal to securitize cost under-recoveries caused by the difference between revenues collected pursuant to its proposed Standard Offer retail price and the cost of service associated with Standard Offer generation supply is *not* authorized under the Act. According to the Act, only reimbursable Transition Costs may be securitized. Deferrals of Standard Offer generation costs are not Transition Costs as defined by the Act. WMECo's request to securitize Standard Offer cost deferrals requires the Department to create a new category of Transition Costs. However, it is clear that the intent of the Act is to mitigate stranded costs, not create new categories of such costs.
2. The Act requires the Department to strike a balance among three somewhat conflicting goals. These include the (1) creation of a competitive generation service market, (2) near-term rate reduction, and (3) the provision for the recovery of costs stranded by the introduction of a competitive retail generation service market.
3. In light of our experience with the Standard Service rates implemented by electric companies since March 1, 1998, the development of a competitive generation service market would be better fostered if the Standard Service rate is set at a price commensurate with the market price of electricity.
4. WMECo's approach does not strike the appropriate balance among the above-mentioned restructuring goals because its proposed Standard Service rate is substantially below the market price of electricity. The market price forecast submitted by WMECo in this proceeding shows that the expected retail market price will exceed the Standard Service rate until year 2003-2004. WMECo's proposal is patently anti-competitive and sacrifices the complete and expeditious transition to a competitive generation market.
5. Setting Standard Service rates to reflect market prices to the maximum extent possible is consistent with the Restructuring Act and policy considerations. There

1 is no compelling reason to establish a uniform Standard Service rate across the  
2 Commonwealth if the pursuit of such a policy comes at the expense of other,  
3 more important legal and policy considerations.  
4

- 5 6. Transition Charges should be based on the total rate cap, including rate reductions  
6 required by the Act, less transmission, distribution and market-based Standard  
7 Offer charges.  
8
- 9 7. Transition Charges would be used to recover reimbursable Transition Costs from  
10 ratepayers. To the extent Transition Charges are not sufficient to recover current  
11 Transition Costs, WMECo would be allowed to defer and potentially securitize  
12 such Transition Costs. Securitization of costs should be permitted only if the  
13 Company can demonstrate that securitization results in lower Transition Charges.  
14
- 15 8. The Company's methodology for estimating Transition Costs should be modified  
16 to incorporate more appropriate cost recovery methods, to exclude costs that are  
17 not Transition Costs, and to account for stranded cost mitigation factors. Some of  
18 the modifications to WMECo's Transition Cost methodology should include:  
19
  - 20 • Eliminating deferrals and securitization costs associated with under-  
21 recoveries of Standard Offer generation costs for 1999 and beyond;  
22
  - 23 • Amortizing the Company's net investment in Millstone 1 over a 12-year  
24 period with no return on the unamortized portion of the investment;  
25
  - 26 • Reflecting a more appropriate nuclear performance based ratemaking  
27 ("PBR") methodology for Millstone 2 and 3 for the period before  
28 divestiture;  
29
  - 30 • Securitizing Millstone 2 and 3 (or any other Company-owned generation  
31 asset for that matter) only after the units have been subject to a market  
32 valuation that fully mitigates stranded costs and defines the true market  
33 value of such units;  
34
  - 35 • Giving the Company a reasonable opportunity to earn a rate of return  
36 authorized by the Act on the undepreciated portion of its Millstone 2 and  
37 3 investment for the period before divestiture;  
38
  - 39 • Using the full expected value of divestiture proceeds when estimating  
40 reimbursable Transition Costs associated with both nuclear and non-  
41 nuclear generation investments;  
42
  - 43 • Allowing the Company to defer and subsequently recover with interest the  
44 foregone revenue associated with the additional 2.4 percent rate decrease

1 in 1998 and the unrecovered costs associated with generation used to serve  
2 the Standard Offer in 1998.

- 3  
4 9. Given the adjustments to the Company's reimbursable Transition Costs described  
5 above, Table 2 shows the resulting Standard Service price and Transition Charges  
6 that represent a better balance among conflicting policy goals -- (1) creating a  
7 competitive market, (2) reducing near-term rates, and (3) providing a reasonable  
8 opportunity for the recovery of reimbursable Transition Costs.  
9

10 **TABLE 2**  
11 **Estimated Standard Service Rates and Transition Charges**  
12 **Using the Methodology Proposed Herein**  
13

<u>Year</u>	<u>Standard Service</u>	<u>Transition Charge</u>
1998	2.800	3.141
1999	4.200	2.157
2000	4.220	2.102
2001	4.200	2.442
2002	4.280	2.744
2003	4.400	2.960
2004-5	4.490	3.207

- 22  
23 10. The numbers presented in Table 2 above must be viewed as illustrative at this  
24 time. This is because actual Standard Offer prices will not be known until the  
25 completion of the Standard Offer procurement process; actual market values of  
26 generation resources will not be known until such assets have been divested; and  
27 because Department findings in subsequent phases of this proceeding may modify  
28 the amount and rate treatment of reimbursable Transition Costs. The tables,  
29 schedules and exhibits presented herein are submitted to illustrate how my  
30 proposed methodology works, and to estimate the expected Standard Offer and  
31 Transition Charge levels based on information available on this record. We  
32 request that the Department approve the Standard Offer Transition Rate  
33 methodology described herein.  
34  
35

1 **III. LEGAL AND POLICY CONSIDERATIONS WITH RESPECT TO STANDARD**  
2 **SERVICE RATE LEVELS**

3  
4 **Q. What policy goals must the Department consider when establishing the Standard**  
5 **Service rate?**

6  
7 A. The Act requires that the Department strike a balance among three somewhat conflicting  
8 goals: These include the (1) creation of a competitive generation service market, (2)  
9 near-term rate reductions, and (3) the provision of a reasonable opportunity for the  
10 recovery of costs that are stranded by the introduction of a competitive retail generation  
11 service market. Striking a reasonable balance among these three goals in the design of  
12 restructuring plans has been the primary challenge faced by policy-makers in the  
13 restructuring debate.

14 **Q. What provision of the Massachusetts Electric Industry Restructuring Act requires**  
15 **the Department to promulgate policies that lead to the expeditious formation of a**  
16 **competitive generation service market?**

17  
18 A. Please refer to St. 1997, c. 164, § 1(s). The legislature found it appropriate and in the  
19 interest of the Commonwealth to introduce competition in the electric generation market,  
20 and that "the transition to a competitive generation market should be orderly and *be*  
21 *completed as expeditiously as possible ....*" St. 1997, c. 164, § 1(s) (emphasis added).

22 **Q. What provision of the Act requires that Standard Service customers receive near-**  
23 **term rate reductions?**

24  
25 A. St. 1997, c. 164, § 193 (G.L. c. 164, § 1B(b)) requires that electric companies offer  
26 "standard service transition rates" which, together with transmission, distribution, and  
27 transition charges, reflect discounts of 10 and 15 percent on March 1, 1998 and  
28 September 1, 1999, respectively, relative to the total average rates in effect as of August

1 1997 or such other date as the Department may determine to be representative of 1997  
2 rates for each electric company.

3 **Q. What provision of the Act authorizes the Department to establish Transition**  
4 **Charges that compensate electric companies to recover Transition Costs?**  
5

6 A. St. 1997, c. 164, §§ 1 (s), (t) and § 193 (G.L. c. 164, § 1G) provide electric company  
7 investors with a "reasonable opportunity" to recover prudently incurred costs associated  
8 with generation-related assets and obligations to the extent that electric companies take  
9 all practicable measures to mitigate such costs, and that such costs have become  
10 uneconomic (i.e., unrecoverable) as a result of the creation of a competitive generation  
11 market.

12 **Q. What economic and legal rationale can you offer which suggests that the creation of**  
13 **a competitive generation service market is as important as achieving near-term rate**  
14 **relief and providing utilities with a reasonable opportunity to recover prudently**  
15 **incurred and fully mitigated Transition Costs?**  
16

17 A. The primary objective of restructuring the Massachusetts electric utility industry is to  
18 introduce competition in the generation service function. For markets that no longer  
19 exhibit the characteristics of a natural monopoly,<sup>6</sup> the economic rationale for replacing  
20 regulation with competition is to encourage greater efficiency, innovation, and improved  
21 services on the part of suppliers. Because of the discipline and opportunities that  
22 competitive markets impose upon suppliers, competition results in lower prices and  
23 expanded services/products when compared to regulated markets, all other things being  
24 equal. In addition, competitive markets provide consumers with price signals that more

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<sup>6</sup> Natural monopoly comes into existence when the minimum total average cost of production occurs at a quantity of output that is sufficient to supply nearly the entire market at a price covering total costs.

1 accurately portray the value of generation services to general society.<sup>7</sup> The Act  
2 recognizes the advantages of competitive markets by indicating that

3 ... competitive markets in generation should (i) provide electricity  
4 suppliers with the incentive to operate efficiently, (ii) open markets  
5 for new and improved technologies, (iii) provide electricity buyers  
6 and sellers with appropriate price signals, and (iv) improve public  
7 confidence in the electric utility industry.... [L]ong-term rate  
8 reductions can be achieved most effectively by increasing  
9 competition and enabling broad consumer choice in generation  
10 service, thereby allowing market forces to play the principal role in  
11 determining the suppliers of generation for all customers.... St.  
12 1997, c. 164, §§ 1(g) and (k).  
13

14 In contrast, it is possible to achieve near-term rate reductions and full recovery of prudent,  
15 but uneconomic generation costs without requiring comprehensive electric industry  
16 restructuring. Near-term rate relief and full recovery of prudent, but uneconomic  
17 generation costs could be simultaneously achieved through aggressive mitigation efforts,  
18 creative ratemaking mechanisms, refinancing of utility capital, etc. This being the case, the  
19 primary goal of electric industry restructuring in general, and indeed the Massachusetts  
20 Electric Industry Restructuring Act in specific, must be to create a competitive generation  
21 service market – to transform the present structure of vertically integrated, monopoly  
22 companies subject to government regulation to a structure characterized by many  
23 companies providing generation services through a competitive market. Accordingly,  
24 economic policy principles and the legal mandate created by the Act require the

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<sup>7</sup> To the extent that the production of generation services produces external costs, such as environmental degradation and a reduction in the quality of human health and welfare, such prices do not reflect full societal costs. Government intervention is required to correct such market failures.

Department to create conditions that are conducive to the expeditious formation of competitive markets to the maximum extent possible.

**Q. What creates the conflict among the near-term rate reduction principle, the Stranded Cost recovery principle and the expeditious creation of a competitive generation service market?**

A. These three principles are somewhat conflicting because increasing the Transition Charge in order to provide greater and/or more expeditious recovery of Transition Costs, or increasing the Standard Service rate in order to encourage the development of a competitive market run the risk of increasing near-term rates. According to the Act, WMECo's Standard Service rates must decrease by at least 10 and 15 percent in 1998 and 1999, respectively. Thus, Transition Charges and Standard Service rates must be set in such a way that an appropriate balance is struck.

**Q. As you are aware, a referendum to repeal the Restructuring Act will appear on the ballot in the Commonwealth's general election this coming November. If the Restructuring Act were to be repealed, thus eliminating the mandate to balance the near-term rate reduction, Stranded Cost recovery, and competitive market principles, do you believe it to be appropriate, as a matter of regulatory policy, for the Department to continue to seek a balance among these principles with respect to the establishment of a Standard Service Rate?**

A. Yes. Even before the passage of the Act, the Department articulated its electric industry restructuring principles in D.P.U. 95-30 and D.P.U. 96-100. Providing for near-term rate relief, stranded cost recovery, where justified, and ensuring the development of a competitive market were among the restructuring principles articulated by the Department. Thus, even before the Act, the Department recognized that, as a matter of policy, electric industry restructuring must satisfy multiple goals. The Department has long recognized that good policy-making involves making decisions that achieve multiple

goals to the maximum extent possible, or to strike the right balance or compromise to the extent such goals cannot be fully achieved simultaneously.

**Q. You previously asserted that WMECo’s proposal to securitize cost under-recoveries caused by the difference between revenues collected pursuant to its proposed Standard Offer retail price and the cost of service associated with Standard Offer generation supply is *not* authorized under the Act. Why?**

A. In written comments dated June 1, 1998 in this proceeding, DOER legal counsel addressed the Company’s “Request for Approval of Standard Offer and Default Service Deferrals and Securitization of the Deferred Amounts.” In its comments, DOER counsel presented a thorough and thoughtful analysis of issues raised by the Company’s request. I refer the reader to those comments and, thus, will not repeat all of the arguments here. In summary, securitization was designed “... to facilitate the provision, recovery, financing, or refinancing of transition costs.” St. 1997, c. 164, § 193 (G.L. c. 164, § 1H(b)(1)). Transition costs that are eligible for securitization are specifically defined in St. 1997, c. 164, § 193 (G.L. c. 164, § 1G); according to this section of the Act, however, Transition Costs do not include cost deferrals associated with the Standard Offer.

Accordingly, DOER counsel concluded that the language of the Act prevents the Department from designating costs associated with Standard Offer deferrals as Transition Costs, and that the intent of the Act is to mitigate stranded costs, not create new categories of such costs. Additionally, DOER counsel reasoned that WMECo’s request to securitize such costs must be denied because only Transition Costs authorized under the Act may be securitized. DOER’s comments are consistent with my reading of the Act.

1 Furthermore, WMECo's proposed use of Electric Rate Reduction Bonds to securitize  
2 Standard Offer cost deferrals allows the Company to use a low-cost and low-risk financing  
3 instrument that is not available to competitive retail suppliers. Thus, allowing WMECo to  
4 securitize cost deferrals associated with the Standard Offer is an additional distortion of  
5 the marketplace which keeps competitive retail suppliers from effectively competing with  
6 the Standard Offer.

7  
8 While the Act does not authorize the securitization of Standard Offer deferrals, it clearly  
9 authorizes the securitization of Transition Costs to the extent such securitization results in  
10 benefits to ratepayers in the form of reduced Transition Charges. In contrast to the  
11 Company's proposal, I propose to apply securitization only to reimbursable Transition  
12 Costs that have been subject to full mitigation in order to minimize Transition Charges,  
13 and to achieve the rate decreases required by the Act.

14 **IV. ESTABLISHING STANDARD SERVICE RATE LEVELS THAT MEET THE**  
15 **REQUIREMENTS OF THE ACT**

16  
17 **Q. With respect to the establishment of Standard Service rates, what general policy**  
18 **must the Department implement so that the transition to a competitive generation**  
19 **market is orderly and completed as expeditiously as possible?**  
20

21 **A.** In order to foster a complete and expeditious transition to a competitive market in the  
22 WMECo service territory, the Standard Service Transition rate for WMECo must be set  
23 at a level that reflects the retail market price for comparable generation services to the  
24 maximum extent possible. To the extent that the price of regulated generation services is  
25 substantially below the market price, the outcome is obvious: competitive suppliers will

1 not be able to offer prices low enough (without the risk of taking substantial financial  
2 losses) to attract customers receiving the regulated Standard Service rate. With few  
3 suppliers entering and serving the market because of the prospect of substantial financial  
4 losses, a competitive market cannot develop.

5 **Q. With respect to its proposed Standard Service rate schedule, does the WMECo**  
6 **restructuring proposal strike an appropriate balance among the three policy goals**  
7 **that we have been discussing?**

8  
9 A. No. WMECo's proposal does *not* strike the appropriate balance because (1) its Standard  
10 Service rate is too low, and (2) its Transition Charge is too high. Thus, WMECo's  
11 proposal sacrifices the complete and expeditious transition to a competitive generation  
12 market while enhancing the collection of its Transition Costs. While this is an  
13 understandable opening position for an electric company to take, it is inconsistent with  
14 the statutory goal of achieving a more appropriate balance. A better balance would be  
15 struck if the Standard Service rate were raised, and the Transition Charge were lowered  
16 subject to the constraint of the mandatory rate reduction percentages required by the  
17 Restructuring Act.

18 **Q. Please explain why you believe that the Company's Standard Service rates are too**  
19 **low.**

20  
21 A. The reason why the proposed WMECo Standard Service rate is too low is because the  
22 rate is substantially below the retail market price of electricity. As mentioned above, the  
23 availability of a Standard Service price that is substantially lower than the retail market  
24 price is a barrier to the development of a competitive generation market. Accordingly, to  
25 support the development of the market, the Standard Service rate must be set at a level  
26 that reflects the retail market price of electricity to the maximum extent possible in order

1 to keep the Standard Service rate from being a barrier to the formation of a competitive  
2 market.

3 **Q. In your opinion, what is the retail market price of electricity in Massachusetts likely**  
4 **to be relative to the standard offer prices proposed by WMECo for the 1998-1999**  
5 **period?**

6  
7 A. The retail market price at the customer meter will be closer to 4 cents per kWh in the  
8 1998-1999 time period than the 2.8 to 3.1 cent per kWh Standard Service retail rate  
9 proposed by WMECo over the same time period.

10 **Q. What evidence can you offer in support of your claim that WMECo's Standard**  
11 **Service rate schedule is below the retail market price of electricity?**

12  
13 A. I can offer several pieces of evidence supporting this conclusion. For example, Northeast  
14 Utilities Service Company ("NUSCO"), an affiliate of WMECo, conducted a retail  
15 market price projection which was sponsored by Frank P. Sabatino, Vice President of  
16 Wholesale Marketing, in Public Service Company of New Hampshire, Docket No. DR  
17 96-150 in November 1997. According to Mr. Sabatino's testimony in that proceeding,  
18 the retail market price in 1998 is over 4 cents per kWh and is about 48 percent higher  
19 than WMECo's proposed Standard Service rate for the same period.<sup>8</sup> Table 3 below

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<sup>8</sup> WMECo Exhibit 13E, Schedule 2, p. 2A of 14, contains a new market price forecast that is very similar to Mr. Sabatino's November 1997 forecast in DR 96-150, except for year 1998. In 1998, the Standard Offer is being supplied by WMECo through the NUG&T. The cost of serving the Standard Offer through the NUG&T consists of two components: (1) a 3.2 cent per kWh "backstop" price resulting in a power cost of \$98 million, plus (2) \$11 million of additional generation costs in excess of the 3.2 cent per kWh "backstop" price (see WMECo Exhibit 13E, Schedule 2, page 3A of 14). Thus, the total cost of serving the Standard Offer in 1998 is estimated to be about \$109 million, or about 3.56 cents per kWh. Accordingly, even the Company's cost of serving Standard Offer load in 1998 greatly exceeds WMECo's proposed Standard Offer price of 2.8 cents per kWh.

shows the difference between NUSCO's recent market price projection and WMECo's proposed Standard Service rates.

**TABLE 3**  
**Difference Between NUSCO Projected Market Prices**  
**and WMECo Proposed Standard Service Rates**

<u>Year</u>	<u>NUSCO</u> <u>Projection*</u>	<u>WMECo</u> <u>Std. Ser.**</u>	<u>Percent</u> <u>Difference</u>
1998	\$0.0414	\$0.0280	48%
1999	\$0.0420	\$0.0310	35%
2000	\$0.0422	\$0.0340	24%
2001	\$0.0420	\$0.0380	10%
2002	\$0.0428	\$0.0420	2%
2003	\$0.0440	\$0.0440	0%
2004	\$0.0449	\$0.0449	0%
2005	\$0.0458	\$0.0458	0%

\* Includes an eight percent average loss factor.

\*\* Reflects WMECo's most recent proposal to charge the prices proposed by the Company on 12/31/97, or a price based on the cost to supply Standard Offer generation, whichever is lower.

In addition, there are numerous articles in the literature regarding the New England electric industry. These articles, some quoting well-known New England electricity market experts, indicate that market prices are well above WMECo's proposed Standard Service price schedule, and that the price differential has a deleterious impact on the formation of the generation service market. Some of these include:

- "[New England Electric System's CEO John] Rowe said the current market price is 3.5 cents, meaning, few competitors could beat the [2.8 cent] standard offer." The Boston Globe (online edition), August 7, 1997.
- "Utilities are expected to fight the ballot initiative [to repeal the Massachusetts Electric Industry Restructuring Act] by launching an expensive advertising campaign. The state is also expected to begin what it is deeming an educational promotion of the complex law. The House last week approved more than \$1 million for that effort, even though many admit it will take at least a year to spur

1 competition because the law artificially lowers electric prices to a point that  
2 outsiders will find hard to match or beat...." "Confusion Reigns as Deregulation  
3 Deadline Looms in Massachusetts." Utility Spotlight, February 23, 1998.

- 4  
5 • "An aggregation effort on behalf of more than 60 high technology companies in  
6 Massachusetts has stalled because competitive suppliers are unable to compete  
7 with the state's standard offer service package that went into effect March 1. The  
8 Massachusetts High Technology Council has suspended its search for a power  
9 supplier, according to the council's Chris Anderson. He said the bids received in  
10 response to the 250 MW request for proposals (RFP) were insufficient when  
11 compared to the state's standard offer service package, which includes a rate cut  
12 of 10% across the board and a charge of 2.8 cents/kWh.... 'The 2.8 cents/kWh  
13 deal can only be beaten by someone willing to take a loss. Most competitive  
14 suppliers will not seek to compete until one year from now, when the rate will  
15 increase to 3.2 cents/kWh, or two years from now, when rates jump to 3.5  
16 cents/kWh,' said Tom Bessette of the state's Dept. of Telecommunications and  
17 Energy." "Mass. Bidders Can't Beat Standard Offer." The Energy Report via  
18 NewsEdge Corporation, March 11, 1998.
- 19  
20 • "Rhode Islanders now pay less for electricity than it costs to utilities to produce it.  
21 That's a bargain .... But the bargain comes at a price .... Further, they say the  
22 restructuring has stifled competition that could mean real savings over the long  
23 term for people who buy electricity .... The generation price utilities are charging  
24 is 3.2 cents a kilowatt-hour, which makes up about one-third of a typical  
25 residential customer's bill. But the actual cost for Narragansett Electric to  
26 generate electricity is about 3.8 cents a kilowatt-hour. ...[O]ther companies that  
27 want to compete with the utilities remain upset because the current utility prices  
28 keep them out of the market.... Such companies say they can't offer 3.2 cents  
29 because it costs more than that to produce electricity. And no one is offering to  
30 subsidize the newcomers so that they can reduce their prices. 'Competition  
31 cannot exist when you allow some suppliers to offer prices well below what  
32 anyone else can deliver,' complained Barbara Kates-Garnick of New Energy  
33 Ventures [and former Commissioner of the DTE], one of those would-be  
34 competitors. "Rhode Island has moved from being a leader in electricity  
35 competition to a state where genuine customer choice will be delayed. Until that  
36 changes, Rhode Islanders will lose in the long run.'" Wyss, Bob. "Critics Say  
37 Rhode Island Electric-Power Restructuring Stifles Competition." Providence  
38 Journal-Bulletin, Knight Ridder/Tribune Business News, March 11, 1998.<sup>9</sup>

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<sup>9</sup> Because the retail price structure of the Standard Offer in Rhode Island is practically identical to that proposed by WMECo in this case, and since Rhode Island and Massachusetts are part of the same regional electricity market, articles describing the Rhode Island standard offer are  
(continued...)

- 1 • "The [Massachusetts electric industry restructuring] program has yet to see  
2 competitive suppliers dueling for ratepayers, and few consumers have left the  
3 standard offer rate of 2.8 cents/kWh. 'There isn't a lot of activity,' [DTE Chair  
4 Janet Gail] Besser said. 'It's a concern.' Only one competitive supplier has been  
5 licensed (National Energy Choice), but the DTE has received 11 applications,  
6 Besser said. She said that the major utilities have shown little interest. 'Very  
7 large players like Enron won't be coming in, in part because of the low standard  
8 offer rates,' Besser said. 'The amount of the standard offer rate is a concern,'  
9 Besser said. 'Competitive suppliers either cannot match the standard offer or  
10 simply are not interested in being a 'lost leader' at this point.'" "Long-Term  
11 Goals Key to Dereg Success, Massachusetts Regulatory Chairman Says." The  
12 Energy Report via NewsEdge Corporation, March 25, 1998.  
13
- 14 • "Rhode Island deregulated its electric power market in January, but the state has  
15 seen little competition due to the low interim standard offer rates. The interim  
16 rates for utilities have averaged 3.2 cents/kWh, an amount which critics say  
17 discourages competition among suppliers.... 'Basically, the utilities are  
18 promoting the status quo,' the PUC's Steve Scialabba said, adding that the  
19 present rates 'won't stimulate retail competition.'" "R.I. utilities file standard  
20 offers, favor status quo." Megawatt Daily, April 28, 1998.  
21
- 22 • "The Rhode Island Public Utilities Commission Friday reluctantly approved a  
23 plan by Narragansett Electric Co. to raise its standard offer electricity rate.... The  
24 regulators also approved on Friday similar standard offer rate increases for the  
25 state's two other electric utilities, Blackstone Valley Electric Co. and Newport  
26 Electric Corp.... All three companies put their standard offer service out to bid  
27 earlier this year, but there were no bidders, as potential service providers said the  
28 state's utilities had priced their own power too low to compete with."  
29 "Regulators Okay Electricity Rate Hike." LCG, June 1, 1998.  
30

31 **Q. Did you estimate retail market prices in New England and did your estimates reveal**  
32 **that retail market prices will be higher than the standard offer prices proposed by**  
33 **WMECo in this case?**  
34

35 **A.** Yes. In January 1997, I managed a project to forecast New England wholesale market  
36 electricity prices while a Senior Consultant for the firm La Capra Associates. This study  
37 was prepared on behalf of the New Hampshire Public Utilities Commission and was

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(...continued)  
particularly relevant here.

submitted as evidence in New Hampshire Public Utilities Commission Docket No. DR 96-150. In that study, we estimated a 1998 market price of about 4 cents per kWh B well above the proposed Standard Service rate of 2.8 cents per kWh for the same year.

**Q. Are you aware of any electricity supply agreements whose price is lower than that of the proposed standard offer?**

A. There are four multi-year agreements of which I am aware that purportedly offer some savings to the Standard Offer at the time of this writing. These agreements include: Massachusetts High Technology Council/PG&E Energy Services, National Energy Choice/Select Energy, Massachusetts Health and Educational Facilities Authority/PECO Energy, The Rhode Island Food Dealers Association/NorAm Energy Management. General details regarding these deals were covered in the trade press. To the best of my knowledge, specific details with respect to these deals including the actual levels of discount relative to the Standard Offer are not publicly available.

**Q. Do these agreements contradict your position that the Company's proposed standard service price schedule will inhibit the development of the competitive market?**

A. No. Looking carefully at the information that is publicly available, we can deduce the types of customers that are allowed to become part of the above-mentioned aggregation groups and, thus, why modest discounts to Standard Offer prices are being offered to such customers. For example, Massachusetts High Technology Council consists of commercial and industrial customers such as EMC Corporation, Data General, Hewlett Packard, and Sun Microsystems; National Energy Choice includes organizations such as the Massachusetts Municipal Association, the Massachusetts Extended Care Federation, the New England Newspaper Association, Hoyt Cinemas, and the Rhode Island

1 Association of School Committees; the Massachusetts Health and Educational Facilities  
2 Authority aggregation consists of public and private colleges and universities, cultural  
3 and scientific institutions, hospitals and museums; and the Rhode Island Food Dealers  
4 Association consists of grocers and related distributors and brokers. While these types of  
5 customers are very diverse in the types of products or services they produce (e.g.,  
6 industrial, hospital/health, educational, cinematic, newspaper, grocery facilities), these  
7 types of customers tend to have similar electrical load characteristics B i.e., high volume,  
8 high load factor, and/or high off-peak use.

9  
10 Because of these favorable load characteristics, suppliers are able to offer such  
11 aggregation groups lower than average prices.<sup>10</sup> However, the customers in these  
12 aggregation groups are not likely to be representative of the bulk of electricity users in  
13 the region. In addition, the multi-year aspect of these deals (five years in most cases)  
14 potentially enable some suppliers to make up losses in the initial years with additional  
15 revenues in future years as the Standard Offer benchmark price rises. Accordingly, while  
16 a select group of customers with favorable loads might be able to find a competitive  
17 supplier willing to offer a multiple-year price schedule that is competitive with the  
18 Standard Offer, the majority are left with no alternative but the Standard Offer. For the  
19 vast majority, therefore, my argument that the Company's proposed Standard Service  
20 price schedule will inhibit the development of the competitive market continues to hold.

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<sup>10</sup> "Cream-skimming" is the pejorative term often used to describe the practice of suppliers targeting customers with such favorable load characteristics.

1 **Q. In light of WMECo's plan to sell its generation assets during the transition period**  
2 **(i.e., the period over which standard service is required to be offered), how can**  
3 **WMECo provide standard service to customers without incurring substantial**  
4 **financial losses if the market price of electricity is higher than its proposed**  
5 **Standard Service rate schedule?**  
6

7 A. WMECo could afford setting the Standard Service rate at a level substantially below the  
8 market price because, as a regulated company, WMECo is able to defer current expenses  
9 in excess of revenues, and to collect such deferrals (including approved carrying charges)  
10 in a future period if approved by the Department. According to the Company's proposal,

11 [i]f ... the revenues received do not recover payments to suppliers,  
12 or the Company defers expenses to meet any inflation cap, the  
13 Company shall accumulate the deficiencies in [an] account,  
14 together with interest as calculated above, and recover those  
15 amounts through the variable portion of the Transition Charge to  
16 the extent permitted in accordance with any applicable inflation  
17 cap. Under-recoveries, if any, that remain after the Standard  
18 Service period ends shall be recovered from all retail delivery  
19 customers by a uniform charge commencing March 1, 2005 and  
20 ending by December 31, 2009.<sup>11</sup>  
21

22 To the extent the Department approves this method of recovery in this case, WMECo, as  
23 a regulated company, is allowed by the Financial Accounting Standards Board ("FASB")  
24 to defer expenses in excess of revenues for accounting purposes, and to capitalize those  
25 costs and book them as so-called "regulatory assets".<sup>12</sup> FASB standards do not require

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<sup>11</sup> See the December 31, 1997 filing of Western Massachusetts Electric Company, D.T.E. 97-120, p. 31.

<sup>12</sup> For example, see FAS 71 and FAS 121. According to **FAS 71, Accounting for the Effects of Certain Types of Regulation**, revenues intended to cover some costs are provided either before or after the costs are incurred for a number of reasons. If regulation provides assurance that incurred costs will be recovered in the future, this Statement requires companies to capitalize those costs. If current recovery is provided for costs that are expected to be incurred in the future, this Statement requires companies to recognize those current receipts as liabilities. **FAS 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be**  
(continued...)

1 that the regulated company be compensated for the time value of money as a condition  
2 for capitalizing regulatory assets. However, WMECo has requested that the Department  
3 approve the accrual of interest on such deferrals, thus compensating WMECo for the  
4 time value of money associated with the deferral. Thus, the Company's proposal leaves  
5 WMECo financially whole over time even if retail Standard Service prices charged by  
6 the Company are lower than the costs associated with acquiring generation to serve the  
7 Standard Offer.

8 **Q. What is the implication of WMECo's proposed Standard Service rate schedule,**  
9 **proposed accounting treatment, and securitization of Standard Offer cost deferrals**  
10 **on the creation of a competitive market?**  
11

12 A. Unregulated retail generation suppliers operating in a competitive market do not have the  
13 option of deferring and collecting interest on cost under-recoveries associated with the  
14 procurement of wholesale generation. Retail suppliers operating in a competitive market,  
15 being unregulated and operating in a contestable market, can never receive a regulator's  
16 Order that could give reasonable assurance that future rates can be set at levels to recover  
17 such deferrals. Thus, unregulated retail suppliers, in contrast to a regulated company

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(...continued)

**Disposed of,** requires that long-lived assets and certain identifiable intangibles that are held and used by an entity be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. In performing the review for recoverability, the entity should estimate the future cash flows expected to result from the use of the asset and its eventual disposition. If the sum of the expected future cash flows (undiscounted and without interest charges) is less than the carrying amount of the asset, an impairment loss is recognized. Otherwise, an impairment loss is not recognized. Measurement of an impairment loss for long-lived assets and identifiable intangibles that an entity expects to hold and use should be based on the fair value of the asset. This Statement also requires that a rate-regulated enterprise recognize an impairment for the amount of costs excluded when a regulator excludes all or part of a cost from the enterprise's rate base.

operating under a Department-approved plan like WMECo's, must report a financial loss if it were to compete with a Standard Service price which is substantially less than the market price. Since unregulated retail suppliers cannot effectively compete with Standard Service on that basis, the retail market cannot develop.

In addition, WMECo's proposed use of Electric Rate Reduction Bonds to securitize Standard Offer cost deferrals allows the Company to use a low-cost and low-risk financing instrument that is not available to competitive retail suppliers. Thus, allowing WMECo to use securitization on cost deferrals associated with the Standard Offer is an additional distortion of the marketplace which keeps competitive retail suppliers from effectively competing with the Standard Offer.

Thus, Standard Service as proposed by the Company is patently anti-competitive and would inhibit the creation of a competitive market.

**Q. Other than supporting the development of a competitive market, are there other reasons why the Standard Service rate ought to reflect the market price to the maximum extent possible?**

A. Increases in the Standard Service rate would reduce potential under-collections of wholesale power costs resulting from the provision of Standard Service. Since WMECo proposed that any such under-recoveries be deferred and eventually collected through Transition Charges levied on *all of the Company's retail delivery customers*, with interest, increasing the current Standard Service rate would decrease the inappropriate allocation of current Standard Offer under-recoveries to those who did not necessarily

benefit from the availability of Standard Service. Since such under-recoveries would be allocated through Transition Charges, those receiving service from competitive suppliers (to the extent that there are any) and future ratepayers who did not receive Standard Service would pay for a portion of the power consumed by Standard Service customers. Eliminating the accumulation of deferrals to the maximum extent possible would reduce or eliminate the potential of non-Standard Service customers subsidizing the rates of Standard Service customers.

**Q. The restructuring plans of other electric companies in the Commonwealth are based on uniform Standard Service rate schedules. Is there any reason why the Standard Service rate ought to be standardized across the Commonwealth?**

A. The Standard Service rate does not have to be standardized across the Commonwealth. First, there is no legal requirement for the establishment of a Standard Service rate that is the uniform rate throughout the Commonwealth **B** the Restructuring Act does not specify what the Standard Service rate should be (in contrast to the Rhode Island Utility Restructuring Act of 1996, for example), nor does it specify that the rate should be the same among all electric companies. Second, there is no policy basis for a uniform rate **B** in light of what is now known, the appropriate policy is to establish a set of rates that strike the best balance among the above-mentioned policy objectives. Third, what standardization there was initially has been effectively eliminated in practice because of the higher Standard Offer rates that electric companies can now charge **B** and still comply with the rate cap **B** because of reductions in Transition Charges resulting from generation asset divestitures.

1 **Q. Do you believe that a Standard Offer price reflecting the wholesale cost of**  
2 **providing Standard Offer generation would eliminate the incentive for customers to**  
3 **move off the Standard Offer, especially later in the transition period?**  
4

5 A. No. The Standard Offer retail price schedule adopted by other Massachusetts electric  
6 companies have rates that are likely to exceed average retail market prices later in the  
7 Transition Period. Because of this, previously approved Standard Offer retail prices do  
8 have the effect of "pushing" customers out into the market in the latter portion of the  
9 Transition Period. However, I believe that the dynamics of the market will also create  
10 incentives for customers to seek alternatives to the Standard Offer in later years under my  
11 proposal.  
12

13 If the Standard Offer price reflects the cost of providing generation to serve Standard  
14 Offer loads, customers that have an average cost of service which is lower than that of  
15 the average Standard Offer customer, because of, say, higher off-peak usage or higher  
16 load factors than the average Standard Offer customer, will eventually be discovered by  
17 suppliers. These better-than-average customers will be attracted off the Standard Offer  
18 which, in turn, raises the average cost of serving the remaining customers. As noted in  
19 my direct testimony dated September 25, 1998 in this proceeding, I proposed that the  
20 Standard Offer bid be held more than once during the Transition Period. Thus, suppliers  
21 of the Standard Offer will begin to incrementally raise the price of serving the remaining  
22 customers in subsequent Standard Offer bids as the average cost of serving the remaining  
23 customers rises. This creates additional incentives for other customers with lower than  
24 average costs to serve to be attracted off the Standard Offer, and so on. Accordingly, I

1 believe that natural market dynamics will result in a shrinking Standard Offer customer  
2 base, reducing the need for an artificially high Standard Offer price schedule in the latter  
3 years of the Transition Period to achieve the same outcome.

4  
5 Also, it is possible that Standard Offer suppliers will bid to provide Standard Offer  
6 service at prices that are somewhat higher than the average spot market electricity prices  
7 in order to hedge against the risk of supply costs outstripping supply revenues. The level  
8 of the hedge is a function of the structure of the Standard Offer bidding system and the  
9 length of commitment required of suppliers to serve the Standard Offer. It is safe to say  
10 that suppliers of the Standard Offer will account for uncertainties in both the cost of  
11 serving Standard Offer load and the quantity of load (and load shape) that might leave or  
12 come back<sup>13</sup> to Standard Offer service. While I have not quantified the level to which  
13 heightened risks would affect Standard Offer bids, it is conceivable that Standard Offer  
14 supply prices will be bid at levels somewhat higher than current market prices to account  
15 for such risks which would, in turn, encourage customers to seek alternative suppliers.

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<sup>13</sup> Low-income customers can come back to the Standard Offer at any time.

1 **V. PROPOSED STANDARD OFFER RATE METHODOLOGY AND**  
2 **MODIFICATIONS TO TRANSITION CHARGE ESTIMATES**  
3

4 **Q. Do you propose that the Standard Service transition rate reflect the market price of**  
5 **such service?**  
6

7 A. Yes. The retail rate for Standard Offer Service should be based on the prices charged by  
8 the suppliers of generation used to serve Standard Offer loads. The suppliers of Standard  
9 Offer generation should be selected pursuant to a fair competitive bidding process.  
10 Issues related to the Standard Offer procurement process were previously addressed in  
11 my direct testimony filed with the Department in this proceeding on September 25, 1998.

12 **Q. How should transmission and distribution charges be set?**

13 A. Transmission and distribution charges ought to be based on the cost-of-service as  
14 reviewed and approved by the Department.<sup>14</sup> The distribution charge ought to include  
15 system benefits charges for demand-side management and renewable energy programs as  
16 required by the Act. See St. St. 1997, c. 164, § 37, §§ 19 and 20.

17 **Q. If the Standard Offer rate is based on the market price for such service, and if**  
18 **transmission and distribution charges are based on the cost-of-service, how do you**  
19 **propose Transition Charges be set in order to comply with the rate cap established**  
20 **by the Act?**  
21

22 A. The Transition Charge should be based on the rate cap (reflecting the rate decreases  
23 required by the Act) less the total average transmission and distribution ("T&D") rate,  
24 and less the market-based Standard Offer retail price.

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<sup>14</sup> Transmission and distribution rates can also be established using a PBR formula. However, establishing a PBR formula for transmission and distribution rates is beyond the scope of my testimony in this proceeding.

1 **Q. If the Transition Charge is the difference between the rate cap and the sum of T&D**  
2 **and Standard Offer charges, what must be done if Transition Charge revenues do**  
3 **not equal Transition Costs?**

4  
5 A. If Transition Charges are not sufficient to cover Transition Cost revenue requirements,  
6 the Company should be allowed to defer and potentially securitize the unrecovered  
7 portion of such Transition Costs. The deferred and/or securitized Transition Costs would  
8 be recovered through Transition Charges to the extent permitted in accordance with the  
9 applicable rate cap. Any remaining under-recoveries after the Standard Service period  
10 should be recovered from all retail delivery customers through Transition Charges.

11 **Q. In order to estimate potential deferrals of Transition Costs given your proposed**  
12 **methodology, do you need an estimate of annual revenue requirements associated**  
13 **with WMECo's Transition Costs?**

14 A. Yes.

15 **Q. Have you estimated the annual revenue requirements associated with WMECo's**  
16 **Transition Costs?**

17  
18 A. Yes, I have.

19 **Q. Please describe how you estimated the annual revenue requirements associated with**  
20 **WMECo's Transition Costs.**

21  
22 A. I used WMECo's Exhibit 13E, Schedule 2 as the starting point for my estimate of annual  
23 revenue requirements associated with the Company's Transition Costs. However, I  
24 modified the Company's methodology to incorporate more appropriate cost recovery  
25 methods, to exclude costs that are not Transition Costs, and to account for stranded cost  
26 mitigation factors. The following modifications were made to WMECo's Transition  
27 Cost schedules:

- 28 • Eliminating deferrals and securitization costs associated with under-recoveries of  
29 Standard Offer generation costs for 1999 and beyond;

- 1 • Amortizing the Company's net investment in Millstone 1 over a 12-year period  
2 with no return on the unamortized portion of the investment;
- 3
- 4 • Reflecting a more appropriate nuclear performance based ratemaking ("PBR")  
5 methodology for Millstone 2 and 3 for the period before divestiture;
- 6
- 7 • Securitizing Millstone 2 and 3 (or any other Company-owned generation asset for  
8 that matter) only after the units have been subject to a market valuation that fully  
9 mitigates stranded costs and defines the true market value of such units;
- 10
- 11 • Giving the Company a reasonable opportunity to earn a rate of return authorized  
12 by the Act on the undepreciated portion of its Millstone 2 and 3 investment for  
13 the period before divestiture;
- 14
- 15 • Using the full expected value of divestiture proceeds when estimating  
16 reimbursable Transition Costs associated with both nuclear and non-nuclear  
17 generation investments;
- 18
- 19 • Allowing the Company to defer and subsequently recover with interest the  
20 foregone revenue associated with the additional 2.4 percent rate decrease in 1998  
21 and the unrecovered costs associated with generation used to serve the Standard  
22 Offer in 1998.
- 23

24 **Q. Were the above-mentioned modifications to WMECo's Transition Cost analysis**  
25 **filed in support of your testimony in this proceeding?**

26

27 A. Yes. Exhibit HYY-6 contains the analysis to which I am referring.

28

29 **Q. Does your use of WMECo Exhibit 13E as the starting point for your Transition**  
30 **Cost computations imply that you support the recoverability of the underlying cost**  
31 **amounts included by the Company in this exhibit?**

32

33 A. No. The primary purpose of Exhibit HYY-6 and of the other Exhibits accompanying my  
34 testimony is to illustrate how my Standard Service Transition Rate methodology  
35 simultaneously satisfies (1) the near-term rate reduction principle, (2) the stranded cost  
36 recovery principle, and (3) the objective of creating a competitive market as completely  
37 and as expeditiously as possible. I am aware that other parties may dispute the  
38 recoverability of some of the costs included in WMECo Exhibit 13E, and that other

1 phases of this proceeding will be devoted to the review of some of these costs. I have not  
2 conducted a detailed review of the cost levels underlying WMECo Exhibit 13E. Thus,  
3 my use of WMECo Exhibit 13E as the starting point for the Exhibits attached to my  
4 testimony should not be construed as support for the recoverability of the values shown.

5 **Q. Why did you eliminate deferrals and securitization costs associated with under-**  
6 **recoveries of Standard Offer generation costs for 1999 and beyond from the**  
7 **Company's Transition Cost analysis?**

8 A. Under my proposed methodology, Standard Offer rates equal the cost of procuring power  
9 to serve Standard Offer loads beginning in 1999. Thus, there is no need for deferrals and  
10 securitization of under-recoveries associated with Standard Offer generation procurement  
11 costs for year 1999 and beyond.

12 **Q. Please explain how you modified the Company's Transition Cost analysis with**  
13 **respect to Millstone 1.**

14 A. On July 24, 1998, Northeast Utilities announced its decision to retire Millstone 1.<sup>15</sup> It is  
15 DOER's position that as a matter of law Millstone 1 annual revenue requirements should  
16 be based on straight-line depreciation of its net book value ("NBV") over a 12-year-  
17 period with no return on the undepreciated balance. The legal basis for this conclusion  
18 will be briefed by DOER later in this proceeding. In this analysis, I reflected this rate  
19 treatment in the fixed portion of WMECo's Transition Charge. Apart from deferrals of  
20 reimbursable Transition Costs that may be necessary to meet rate reduction targets, the  
21 Company would not be allowed to securitize its net investment in Millstone 1. In this

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<sup>15</sup> Of course, Millstone 1 was off-line well before Northeast Utilities announced its decision to retire the plant.

1 particular instance, securitizing an asset which is not permitted to earn a return would  
2 raise total revenue requirements.

3  
4 Straight-line depreciation of the Millstone 1 investment without a return is reflected on  
5 Exhibit HYY-6, page 2. The exclusion of any costs associated with the securitization of  
6 Millstone 1, which is reflected on Exhibit HYY-6, page 11, results in a reduction in the  
7 Company's "Interest Mortgage Payments" which is reflected on Exhibit HYY-6, page 2.

8 **Q. Please explain how you modified the Company's Transition Cost analysis with**  
9 **respect to Millstone 2 and 3?**

10  
11 A. Millstone 2 and 3 annual revenue requirements should be based on the following  
12 principles:

- 13 1. The variable portion of the Transition Charge should reflect PBR benefits  
14 proposed by DOER's PBR witness whose testimony will be filed later in this  
15 proceeding. The Company's proposed PBR formula allocates only 25 percent of  
16 the annual revenues in excess of going-forward costs in Transition Charges.  
17 Since I propose that the Company be allowed to earn its full authorized rate of  
18 return on Millstone 2 and 3 ratebase, crediting ratepayers only 25 percent of the  
19 going-forward profits associated with unit operation is inadequate. For analytical  
20 purposes, my computation of the variable portion of the Transition Charge  
21 reflects the Company's estimate of PBR benefits reflected in Exhibit 13E  
22 multiplied by a factor of four in order to credit ratepayers the full market value of  
23 Millstone 2 and 3 during the period before divestiture. This modification is  
24 reflected on Exhibit HYY-6, page 3.  
25
- 26 2. The Company should not be allowed to securitize its investment in Millstone 2  
27 and 3 before divestiture. Thus, I excluded from the Company's "Interest  
28 Mortgage Payments" any costs associated with the securitization of Millstone 2  
29 and 3. These modifications are reflected on Exhibit HYY-6, pages 2 and 11.  
30
- 31 3. Before divestiture, NBV of Millstone 2 and 3 should be afforded traditional  
32 ratebase treatment where the gross plant is amortized on a straight-line basis over

1 the life of the unit. As of now, the Company estimates that the remaining life is  
2 17 years for Millstone 2, and 27 years for Millstone 3. These adjustments are  
3 reflected on Exhibit HYY-6, page 11.  
4

- 5 4. The Company should earn a return on the undepreciated book investment (net of  
6 accumulated deferred income taxes) based on the Company's embedded cost of  
7 capital where the return on equity component reflects the levels authorized by the  
8 Act in St. 1997, c. 164, § 193 (G.L. c. 164, § 1G(b)(3)(a-c)).<sup>16</sup> This modification  
9 was reflected on Exhibit HYY-6, page 12.  
10

11 **Q. Did you estimate the sale proceeds that the Company is likely to earn from the**  
12 **divestiture of Millstone 2 and 3 and include this estimate in your computation of**  
13 **WMECo Transition Costs?**  
14

- 15 A. Yes. The Transition Costs associated with Millstone 2 and 3 should be determined net of  
16 full mitigation value. Full mitigation requires that all proceeds from the sale of  
17 generation assets (also known as the market or residual value of such assets) be included  
18 as an offset to total Transition Costs. While the true amount of sale proceeds can be  
19 known only after the units have been subject to a fair competitive offering, it is  
20 reasonable to estimate such proceeds for the purpose of estimating net Transition Costs  
21 based on information that is part of the record. Once sold, the Company should be  
22 allowed to securitize any remaining Transition Costs. For analytical purposes, I  
23 estimated the sale proceeds earned from the sale of Millstone 2 and 3 based on the  
24 Company's stated commitment that these assets would be sold by December 31, 2003.

---

<sup>16</sup> Company Exhibit 13E, Schedule 2, page 12 uses a return on equity of 10.7 percent in 1998. Apparently, the Company assumed it could not charge its authorized 11 percent return on equity because of the constraint imposed by the rate cap. Our proposal creates sufficient "head room" to allow the Company to earn its authorized return on equity in 1998. Accordingly, we increased the Company's proposed return on equity from 10.7 to 11 percent in 1998.

1 In addition, my estimate of Transition Costs was based on the following assumptions for  
2 analytical purposes:

- 3 1. The principal to be securitized should be the NBV of Millstone 2 and 3 as of  
4 year-end 2003 minus the market value (i.e., the sale proceeds) acquired from the  
5 sale of the units. For analytical purposes, the net present value of going-forward  
6 revenues less going forward costs was used as a proxy for the market value of  
7 Millstone 2 and 3. The remaining NBV not recovered by the estimated market  
8 value is securitized and reflected in Transition Costs beginning in 2004. The  
9 securitization amount is reflected on Exhibit HYY-6, page 11.
- 10  
11 2. The Company's estimate of going-forward revenues and costs from WMECo's  
12 computation of PBR benefits was the basis for my estimate of the market value of  
13 Millstone 2 and 3 for analytical purposes. The Company's estimate was  
14 appropriately projected to estimate going-forward revenues and costs not covered  
15 for those years over which these units are expected to operate, but were not  
16 analyzed by the Company.

17 Exhibit HYY-7 shows my projection of Millstone 2 and 3 market value based on the  
18 Company's PBR computations. Exhibit HYY-7 also indicates the estimated percentage  
19 of Millstone 2 and 3 NBV, as of year-end 2003, that is not recovered by the expected  
20 market value of these generation assets. My analysis assumes that the NBV not  
21 recovered by the market would be securitized and subsequently recovered in Transition  
22 Charges.

23 **Q. Please describe how Exhibit HYY-7 estimates the market value of Millstone 2 and 3.**

24  
25 A. The first step in estimating the projected market value of generation assets is to obtain an  
26 annual pre-tax operating margin. The annual pre-tax operating margin is calculated by  
27 subtracting projected annual going-forward operating costs from projected annual  
28 revenues earned from sales of generation produced by each asset. Going-forward  
29 operating costs include items such as fuel costs, operation and maintenance expenses,

1 capital additions, administrative and general expenses, interest on working capital, and  
2 taxes other than income taxes. The next step is to deduct income taxes from the pre-tax  
3 operating margin in order to obtain the after-tax operating margin for each asset. The  
4 final step is to discount the annual after-tax operating margins using an after-tax  
5 weighted average cost of capital to yield the projected market value of each asset. The  
6 net present value of estimated after-tax operating margins earned by each generation  
7 asset is the basic estimate of the asset's market value.<sup>17</sup> Factors other than the net present  
8 value of expected generation asset earnings could influence the value that a potential  
9 buyer would place on the asset. For example, the value of the site and its proximity to  
10 transmission access will increase the sale value of the generation asset independent of the  
11 expected future productivity of the asset. Also, additional cost mitigation and the  
12 contribution of individual generation assets to the size and value of a portfolio of  
13 generation resources could increase the sale value of such assets. However, Exhibit  
14 HYY-7 does not attempt to capture some of these other factors.

15  
16 Taxable income was determined for each generation asset by subtracting annual  
17 depreciation from the projected annual pre-tax operating margin. Income taxes were  
18 computed using a composite Federal and state tax rate of 40.6059 percent (which is the  
19 same rate as that used by the Company in WMECo Exhibit 13E, Schedule 2, page 4 of  
20 14). Although interest is also a tax-deductible expense, Exhibit HYY-7 does not

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<sup>17</sup> Generation assets whose going-forward costs exceed projected revenues on a net present value basis are prime candidates for retirement. Continued operation of such units could add to stranded costs, thus violating the principle of stranded cost mitigation.

1 discretely deduct interest expenses from taxable income. This is because such a  
2 deduction is accounted for through the use of a discount rate based on the after-tax cost  
3 of capital. Starting with the Company's weighted average cost of capital estimate of 8.59  
4 percent from WMECo Exhibit 13E, Schedule 2, page 12 of 14, I computed an after-tax  
5 cost of capital of 7.30 percent. Thus, a 7.30 percent discount rate was used to compute  
6 the net present value of after-tax operating margins.

7 **Q. The Company's revised restructuring plan proposes to securitize 90 percent of its**  
8 **Millstone 2 and 3 investment in 1999. What is your opinion with respect to this**  
9 **proposal?**

10  
11 A. The reason given by the Company to securitize 90 percent of its Millstone investment is  
12 to:

13 "... provide an appropriate and significant 'cushion' to assure that too  
14 much of nuclear plant costs, which may be subject to dispute in this  
15 proceeding that may continue for some time, are not securitized  
16 initially."<sup>18</sup>  
17

18 While I agree with the Company that we ought not securitize stranded costs that are  
19 subject to dispute in this proceeding, I have several problems with the Company's  
20 proposed approach. First, WMECo provided absolutely no basis for the 90 percent  
21 figure. WMECo's approach implies that the residual value of its assets is 10 percent  
22 since it is seeking to securitize 90 percent of Millstone 2 and 3 NBV. However, WMECo  
23 has presented no evidence suggesting that the expected market value of Millstone 2 and 3  
24 is 10 percent of its NBV. Second, the evidence based on information from the  
25 Company's PBR computations suggest that a reasonable projection of Millstone 2 and 3

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<sup>18</sup> See the May 15, 1998 filing of Western Massachusetts Electric Company, D.T.E. 97-120, Tab 1, p. 4.

1 going-forward revenues and costs indicates that these investments have market values  
2 substantially in excess of 10 percent of NBV (see Exhibit HYY-7).

3  
4 Third, WMECo is seeking to securitize its investment well in advance of establishing a  
5 residual value credit for Millstone 2 and 3. Counsel for the DOER have previously  
6 argued that the securitization of Transition Costs must be preceded by mitigation  
7 including, but not limited to, the crediting of the "residual value" of assets. See the  
8 Comments of DOER dated May 1, 1998 in D.T.E. 97-120. The Act prohibits the  
9 Department from approving a financing Order for the securitization of Millstone 2 and 3  
10 assets until the Company has accounted for maximum possible mitigation. Given that  
11 the Company has not provided a credible estimate for the residual value credit associated  
12 with Millstone 2 and 3, the Company has not accounted for maximum possible  
13 mitigation. Accordingly, it is DOER's position that the Department would be required to  
14 deny the Company's securitization proposal.

15 **Q. Did you make any adjustments to Transition Costs associated with Northfield**  
16 **Mountain and related facilities (i.e., Cabot and Turner's Falls)?**

17  
18 A. No, I did not. Before divestiture, I believe that the revenue requirements associated with  
19 Northfield Mountain and related facilities (Cabot and Turner's Falls) should be recovered  
20 in the same manner as that proposed above for Millstone 2 and 3 before divestiture  
21 (including PBR treatment of the going-forward revenues less going-forward costs). It  
22 appears that the Company's proposal in which the cost and benefits associated with the  
23 output of these units are treated as a purchase power contract for the period before  
24 divestiture mimics my proposal with respect to these units. However, I would add that

1 the Company should not be allowed to pass on to ratepayers any going-forward costs in  
2 excess of going-forward revenues under any circumstance.<sup>19</sup> Since unit operations are in  
3 the control of the Company and its affiliates, and since the Company is required to  
4 mitigate its stranded costs (rather than increase them), it is appropriate to give the  
5 Company an incentive to minimize the costs and maximize revenues associated with unit  
6 operations. Shielding ratepayers from going-forward costs in excess of going-forward  
7 revenues gives WMECo the appropriate incentives to mitigate its stranded costs.

8  
9 For analytical purposes, therefore, I accepted the Company's estimate of revenue  
10 requirements net of going-forward revenues associated with Northfield Mountain and  
11 related facilities. However, after divestiture of these units (which is scheduled for mid-  
12 1999), I computed and included in my estimate of Transition Costs an estimated residual  
13 value credit based on WMECo's assumption that the sale of such units would result in  
14 proceeds that are two times NBV. This modification to the Company's Transition Cost  
15 analysis is reflected in Exhibit HYY-6, page 2.

16 **Q. You computed a residual value credit for Northfield Mountain and related**  
17 **facilities. Did you compute a residual value credit for the Company's other non-**  
18 **nuclear units?**

19  
20 **A.** Yes. For all other non-nuclear units that are projected to be divested at the beginning of  
21 1999, I estimated a residual value credit based on WMECo's assumption that such units

---

<sup>19</sup> If allowed to increase Transition Charges when operating costs exceed operating revenues, there should be substantial restrictions in the proportion of overrun costs reflected in Transition Charges.

1 will be sold at two times NBV. The residual value credit associated with these other  
2 non-nuclear units was reflected in the Transition Cost analysis beginning in 1999 for  
3 analytical purposes. This adjustment is reflected in Exhibit HYY-6, page 2.

4 **Q. You mentioned that you based your Transition Cost analysis on the Company's**  
5 **assumption that non-nuclear generation would sell for two times net book value.**  
6 **Did the Company also include a residual value credit in its computation of**  
7 **Transition Costs?**

8  
9 A. While the Company computed a residual value credit based on the assumption that its  
10 total non-nuclear asset base would sell for two times NBV in its analysis of Transition  
11 Costs (see Exhibit 13E, Schedule 2, page 4 of 14), the residual value credit was not used  
12 to reduce total Transition Charges (see Exhibit 13E, Schedule 2, page 2 of 14, Col. F).  
13 By neglecting to account for the expected impact of the residual value credit on total  
14 Transition Costs, the Company's estimate of Transition Charges is biased on the high  
15 side. My estimate of Transition Charges accounts for the expected impact of the residual  
16 value credit on total Transition Costs. Of course, once the Company sells its generation  
17 assets, the residual value credit should be based on actual sale asset values.<sup>20</sup>

18 **Q. How did you treat regulatory assets in your computation of Transition Costs?**  
19

20 A. Existing regulatory assets were reflected in Transition Costs in the same manner as the  
21 Company's proposal. In addition, the Company should be allowed to securitize  
22 regulatory assets for which the Company has been authorized to earn a return. For

---

<sup>20</sup> I also included, without endorsement, the Company's proposed 4 percent incentive in the variable portion of the Transition Charge. This incentive is reflected on Exhibit HYY-6, page 3.

1           analytical purposes, my computation of Transition Costs reflects the securitization of  
2           existing regulatory assets in the same manner as the Company's proposal.

3   **Q.    What assumptions did you make with respect to the securitization of assets in your**  
4   **computation of Transition Charges?**

5  
6   A.    For computational purposes, my estimate of annual payments resulting from  
7           securitization of reimbursable Transition Costs, and Transition Cost deferrals if needed to  
8           meet the rate cap constraint imposed by the Act,<sup>21</sup> was based on a 6.25 percent interest  
9           rate. For regulatory assets authorized to earn a return, such assets were securitized over a  
10          12-year term. Securitization of the above-market portion of Millstone 2 and 3 NBV was  
11          carried over a 6-year term (i.e., from 2004 through 2009). A longer amortization period  
12          could be used if needed to achieve a larger near-term rate decrease. However, our  
13          computations show that a longer amortization period does not appear to be necessary at  
14          this time.

---

<sup>21</sup> WMECo Exhibit 6, which computes the 1998 rate cap based on 1997 average rates, does not provide an additional rate reduction to those customers with contracts for electricity sales that already provide for discounts below cost-based or tariffed rates. In this respect, WMECo Exhibit 6 appears to be consistent with the Act. See, St. 1997, c. 164, § 193 (G.L. c. 164, § 1B(b)). My analysis of the rate cap in the Exhibits attached to this testimony makes the implicit assumption that such contracts for electricity sales would be in effect through the Transition Period and, therefore, does not account for contracts that may be in effect for only a portion of the Transition Period.

1 **Q. If Transition Charges are not sufficient to cover Transition Cost revenue**  
2 **requirements, you mentioned that the Company should be allowed to defer and**  
3 **potentially securitize the unrecovered portion of such Transition Costs. Were any**  
4 **such deferrals necessary?**

5  
6 A. Yes. My analysis shows that some deferrals of Transitions Cost are necessary to comply  
7 with the rate cap.<sup>22</sup> I propose that the Company be allowed to defer recovery of such  
8 costs, to earn carrying charges on the cost deferrals, and to recover such deferrals through  
9 Transition Charges to the extent permitted in accordance with the applicable rate cap.  
10 Any remaining under-recoveries after the Standard Service period should be recovered  
11 from all retail delivery customers through Transition Charges.

12  
13 In addition, my computations reveal that securitizing Transition Cost deferrals does not  
14 appear to be necessary. This is because such deferrals, including carrying charges on the  
15 cumulative deferred amounts, can be completely recovered by year 2005.<sup>23</sup> My estimate  
16 of Transition Cost deferrals and their recovery is shown on Exhibit HYY-8.

17 **Q. Could these deferrals potentially cause cash flow problems for WMECo?**

18  
19 A. While I did not conduct a detailed cash flow analysis, I doubt that my proposal will cause  
20 severe cash flow problems for the Company. The reason for my opinion is that my  
21 proposal creates lower cash deferrals than does the Company's proposal. Looking at

---

<sup>22</sup> My proposed methodology results in lower total deferrals than that produced by the Company's method of deferring Standard Offer under-recoveries (compare Exhibit HYY-8 with WMECo Exhibit 13E, Schedule 2, page 2A of 14).

<sup>23</sup> An 8.59 percent rate, WMECo's cost of capital, was used to determine carrying charges for Transition Cost deferrals.

1 WMECo Exhibit 13E, Schedule 2, page 2A of 14, the Company's proposal anticipates  
2 cash deferrals associated with Standard Offer under-recoveries of about \$104 million  
3 over the period 1998 through 2003 *without interest*. Purchasing power to supply the  
4 Standard offer is real cash expense. Thus, WMECo's proposal to defer such under-  
5 recoveries, combined with securitization not being available to finance such under-  
6 recoveries as explained above, will create significant cash pressure on the Company.

7  
8 My proposal of basing the Standard Offer retail price on the cost of providing Standard  
9 Offer service eliminates the above-mentioned cash flow pressure on WMECo because  
10 Standard Offer revenues would equal Standard Offer costs. In addition, my proposal  
11 creates a lower level of total deferrals that need to be carried and recovered. According  
12 to Exhibit HYY-8, total deferrals **C** both the under-collections of power costs in 1998  
13 and Transition Cost deferrals **C** reach their maximum level in year 2001 and equal only  
14 \$46 million, *including interest*. In addition, my analysis shows that all deferrals would  
15 be fully recovered by the end of 2005. Lower deferrals that are carried over a shorter  
16 period of time create less cash flow pressure on the Company. Finally, in contrast to  
17 Standard Offer under-recoveries, not all of the deferred Transition Costs are cash  
18 expenses. Annual Transition Cost revenue requirements include expenses such as  
19 depreciation charges on the Company's Millstone investments. Annual depreciation  
20 charges are not cash expenses. In addition, interest charged on the annual deferrals,  
21 while part of Transition Cost revenue requirements, are not cash expenses. Accordingly,

1 the deferral of such expenses does not create the same cash flow problem as would the  
2 deferral of Standard Offer under-recoveries.

3  
4 If the deferral of Transition Costs creates cash flow problems for the Company, WMECo  
5 is free to make its case and to request securitization of some of these deferrals in a future  
6 financing proceeding. For ratemaking purposes, such securitization would have the  
7 effect of changing the pattern of Transition Cost collection over the Transition Period.<sup>24</sup>

8 **Q. Starting July 1998, the Company provided an additional 2.4 percent rate decrease**  
9 **in order to provide a 10 percent rate decrease from actual August 1997 rates. The**  
10 **actual August 1997 rate happened to include a temporary credit in effect at that**  
11 **time. The Company proposes to defer and securitize the reduction in revenues**  
12 **associated with this additional 2.4 percent decrease. What should be done with**  
13 **respect to the Company's proposal to defer and securitize this amount?**

14  
15 A. I agree with the Company that the foregone revenue associated with the additional 2.4  
16 percent rate decrease in 1998 should be deferred. However, I do not agree that the  
17 amount should be securitized. Similar to deferrals of Standard Offer generation costs in  
18 excess of Standard Offer revenues, deferrals associated with the additional 2.4 percent  
19 rate decrease are not Transition Costs as defined by the Act. Only Transition Costs can  
20 be securitized according to the Act. DOER counsel briefed this issue extensively in its  
21 June 1, 1998 comments to the Department in this proceeding.

22  

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<sup>24</sup> Similarly, acceptance of the Company's proposal, while not advised, would require a series of separate financing proceedings in which the Department must issue financing Orders to authorize the securitization of deferred Standard Offer under-recoveries.

1 Accordingly, I excluded the deferral associated with the 2.4 percent decrease from the  
2 category of costs for which the Company is seeking securitization. In addition, I allowed  
3 the Company to subsequently recover the deferred amount through a deferral mechanism  
4 to the extent permitted in accordance with the applicable rate cap. I allowed the  
5 Company to accrue interest on the unrecovered balance using a rate of interest associated  
6 with customer deposits. This is consistent with the treatment of Standard Offer under-  
7 and over-recoveries previously approved by the Department. According to my  
8 computations, the under-collection associated with the 2.4 percent rate reduction, when  
9 combined with deferrals of 1998 Standard Offer under-recoveries as explained below,  
10 would be fully recovered through the deferral mechanism by the year 2005. An  
11 additional 0.337 cent per kWh rate must be charged to all customers in 2005 in order to  
12 collect the deferrals, including interest, associated with the 2.4 percent rate reduction and  
13 the 1998 Standard Offer under-recoveries. Exhibit HYY-8 reflects this adjustment to the  
14 Company's Transition Cost estimates.

15 **Q. The Company had been providing generation to supply the Standard Offer during**  
16 **1998. While the retail Standard Offer was priced at 2.8 cents per kWh in 1998, the**  
17 **Company's cost to serve the Standard Offer was substantially higher. According to**  
18 **Exhibit 13E, Schedule 2, page 14 of 14, WMECo proposes to securitize a portion of**  
19 **the undercollection (over \$12 million). The Company also plans to recover the**  
20 **remaining portion (about \$11 million) in the variable portion of the Transition**  
21 **Charge in 1998 (see Exhibit 13E, Schedule 2, page 3, col. N, and page 3a of 14).**  
22 **What should be done with respect to these under-recovered Standard Offer**  
23 **generation costs?**

24  
25 A. I previously argued that deferrals of Standard Offer cost under-recoveries should not be  
26 securitized. Thus, this portion of the Company's proposal must be modified. I excluded  
27 the deferral associated with the \$12 million of under-recovered Standard Offer costs

1 from category of costs for which the Company is seeking securitization. In addition, it  
2 appears that the Company is charging ratepayers, through the variable portion of the  
3 Transition Charge, an additional \$11 million of excess power generation costs associated  
4 with serving the Standard Offer in 1998. In my calculation of WMECo's Transition  
5 Costs, I allowed the Company to defer and subsequently recover both Standard Offer  
6 under-recoveries (i.e., both the \$12 and \$11 million) through a deferral mechanism to the  
7 extent permitted in accordance with the applicable rate cap. I allowed the Company to  
8 accrue interest on the unrecovered balance using a rate of interest associated with  
9 customer deposits. This is consistent with the treatment of Standard Offer under- and  
10 over-recoveries previously approved by the Department. According to my computations,  
11 the Standard Offer deferrals, combined with the under-collection associated with the 2.4  
12 percent rate reduction as explained above, would be fully recovered through the deferral  
13 mechanism by year 2005.<sup>25</sup> An additional 0.337 cent per kWh rate must be charged to all  
14 customers in 2005 in order to collect the deferrals, including interest, associated with the  
15 1998 Standard Offer under-recoveries and the 2.4 percent rate reduction. Exhibit HYY-8  
16 reflects this adjustment to the Company's Transition Cost estimates.

17  
18 **VI. ESTIMATED STANDARD SERVICE PRICES AND TRANSITION COSTS**

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<sup>25</sup> In addition, the Company's Transition Charge of 3.18 cents/kWh for the period 3/1/98 through 6/30/98, and 3.141 cents/kWh for the period 7/1/98 through the end of the year creates an Transition Charge over-collection of about \$16 million for 1998. This over-collection was subtracted from the sum of the cost deferrals associated with Standard Offer under-recoveries and 2.4 percent rate decrease in 1998.

1 **Q. According to your proposed Standard Service Transition rate methodology and**  
2 **given the adjustments that you have made to the Company's Transition Cost**  
3 **analysis, what is the resulting Standard Service price that you believe represents the**  
4 **best balance among conflicting policy goals -- near-term rate relief, Stranded Cost**  
5 **recovery, and the expeditious development of the market?**

7 A. Table 4 below shows my estimated Standard Service rates for the seven-year transition  
8 period required by the Restructuring Act based on my proposed methodology. I should  
9 note that these rates are estimates only. The actual rates should be based on the winning  
10 bids made by suppliers selected through a fair and competitive Standard Offer  
11 procurement process.

12 **TABLE 4**  
13 **Estimated Standard Service Transition Rates**

<u>Transition Year</u>	<u>Price (cents per kWh)</u>
1999	4.20
2000	4.22
2001	4.20
2002	4.28
2003	4.40
2004-5	4.49

23 **Q. Do your recommendations on Standard Service rates meet the mandatory rate**  
24 **reductions required by the Restructuring Act?**

26 A. Yes. Table 5 below shows my estimated Standard Service rate, together with  
27 distribution, transmission and Transition Charges, that comply with the mandatory rate  
28 targets required by the Restructuring Act. The figures included in Table 5 below are  
29 based on Exhibit HYY-8 attached to this testimony. As stated above, the actual Standard  
30 Service Charge and the actual Transition Charge would be known only after suppliers of  
31 Standard Service generation have been identified through a fair and competitive  
32 procurement process. In addition, Department findings in this or future proceedings

regarding the magnitude of costs that may be reimbursed through Transition Charges may change the overall level of recoverable Transition Costs. Also, the actual value of divested generation assets, PBR credits, and purchased power contracts are likely to vary from those estimated herein. Thus, the actual level of Transition Charges would be known only after actual market values have been established. It should be noted, however, that this aspect of my analysis is no different than WMECo's analysis of Transition Costs since the Company's analysis also relies upon assumptions of generation market values.<sup>26</sup>

**TABLE 5**  
**Estimated T&D, Transition and Standard Service Charges**  
**And Compliance with the Rate Cap (cents/kWh)**  
**(for illustrative purposes)**

	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
Distribution Rate	2.763	2.763	2.763	2.763	2.763	2.763	2.763
DSM Rate	0.330	0.310	0.285	0.270	0.250	0.250	0.250
Renewables Rate	0.075	0.100	0.125	0.100	0.075	0.075	0.075
Transmission Rate	0.317	0.317	0.317	0.317	0.317	0.317	0.317
Transition Charge	3.141	2.157	2.102	2.442	2.744	2.960	3.207
<u>Standard Service Rate</u>	<u>2.800</u>	<u>4.200</u>	<u>4.220</u>	<u>4.200</u>	<u>4.280</u>	<u>4.400</u>	<u>4.490</u>
Total of Unbundled Rates	9.426	9.847	9.812	10.092	10.429	10.765	11.102
Rate Cap	9.426	9.847	9.812	10.092	10.429	10.765	11.102

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<sup>26</sup> For example, the Company's proposed Transition Charge would vary depending on the actual residual value credit associated with asset sales, the Company's PBR credit associated with sales of nuclear generation, and the cost of power purchase contracts net of the market value of power.

1 **Q. On what did you base your estimate of market-based Standard Offer prices, and of**  
2 **average T&D rates?**

3  
4 A. For computational purposes, the market-based Standard Offer rate was based on the  
5 Company's projection of market prices found in WMECo's Exhibit 13E, Schedule 2,  
6 page 2A of 14. T&D revenue requirements from Company Exhibit 6 were used as the  
7 basis for average T&D rates.

8 **Q. Please summarize your conclusions.**

9 A. The Restructuring Act requires that a balance be struck among the three restructuring  
10 goals of (1) near-term rate reduction principle, (2) the stranded cost recovery principle,  
11 and (3) the creation of a competitive market. WMECo's methodology with respect to the  
12 establishment of the Standard Service Transition Rate falls short of achieving the balance  
13 required by the statute. My proposed methodology for establishing the Standard Service  
14 Transition Rate achieves the balance required by the statute. Accordingly, I recommend  
15 that the Department consider and adopt the changes described herein for the  
16 establishment of Standard Service rates.

17 **Q. Does this conclude your testimony?**

18 A. Yes, it does.